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SUBJECT: ROSTECHNOLOGII DIRECTOR CHEMEZOV SEEKS MORE STATE
SUPPORT; SUPPORTS GM AND BOEING INVESTMENTS

Classified By: AMBASSADOR JOHN BEYRLER, REASONS 1.4 (B,D)

SUMMARY

¶1. (C) In a March 20 meeting with the Ambassador, Director General of Rostekhnologii, Sergei Chemezov, stated that many of the conglomerate's constituent corporations would likely close owing to the economic crisis. Thirty percent of Rostekhnologii's defense plants were on the verge of bankruptcy, and half of them would eventually shut down. On the other hand, Rostekhnologii would receive sufficient government support (mostly in state guarantees and interest rate compensation on bank loans) to sustain its major enterprises, such as the car manufacturer, Avtovaz. Chemezov said Rostekhnologii's joint venture with Boeing is scheduled to open in June or July, and in that regard noted that Rostekhnologii's aviation arm, Rosavia, was planning to put out a tender for the purchase of up to 100 Boeing or Airbus aircraft. Finally, he noted that production at GM's joint venture with Avtovaz would be halved this year owing to the decline in Russian auto sales. End Summary.

Economic Crisis: Winners and Losers

¶2. (C) Chemezov said that when the military-industrial conglomerate Rostekhnologii was formed in 2007, it not only absorbed the assets of the state arms exporter, Rosobnronexport, but acquired 450 additional entities, including 180 state corporations, mostly in the defense, machine building, aviation, auto manufacturing and metallurgy sectors. (Note: Rostekhnologii owns stakes in VSMPO Avisma, a supplier of titanium to Boeing, and Avotvaz, Russia's biggest car manufacturer, which has a joint venture with GM in Togliatti. It is also the majority shareholder in Rosavia, a collection of several bankrupt regional carriers. End Note.)

¶3. (C) Chemezov said Rostekhnologii needed to conduct an auditing of the acquired assets in order to establish their real value and prepare many of them for public auction; a process that could take up to two years. In order to speed up the auditing process, Chemezov was seeking legislation from the Duma allowing Rostekhnologii to assume immediate management of the 100 percent owned state corporations (unitarniye predpriyaiya) that had been handed over to it. The state corporations were presently under the control of the government State Property Agency.

¶4. (C) Chemezov said that many of Rostekhnologii's constituent enterprises would have to be closed, "causing pain" for many workers. Driving this process was not just

the downturn, but \$800 million in debt Rostekhnologii had inherited when it assumed control of these enterprises, and which was continuing to mount as many of these firms lost value. Enterprises in the single company towns, i.e., Avtovaz, would continue to operate and receive state funding. However, smaller enterprises that did not contribute significantly to Rostekhnologii's major product lines would have to close.

15. (C) Chemezov hoped that the crisis would bottom-out by the end of the year, but predicted that economic recovery, particularly in the manufacturing sector, would take at least three or four years. This would put enormous pressure on the company's weaker components.

Defense Industries

16. (C) Among those weaker components were defense related firms, according to Chemezov. Rostekhnologii included 19 holding companies in defense related industries, including radio-electronics, aviation equipment; and manufacturing of motors, ammunition and conventional weapons. Thirty percent of the defense plants were on the verge of bankruptcy, he said, and about half of those plants would eventually be closed.

State Financing

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17. (C) Chemezov said he was confident that Rostekhnologii would obtain a large part of the state funding it had requested. He said that he had been working directly with Deputy Prime Minister Shuvalov, who would make the final decision on how much and where the cuts to Rostekhnologii's budget would be made. (Note: Rostekhnologii is one of only seven state-owned corporations that receive money directly from the federal budget. Rostekhnologii received \$5 billion last fall and is now reportedly seeking another \$7.22 billion in GOR capital contributions and state guarantees. End note.)

18. (C) Chemezov said the bulk of government support would be in the form of guarantees for bank credits and interest rate compensation. He complained about the high interest rates for commercial bank credits, which he said the Finance Minister had attributed to inflation. "Compensating us for high interest rates is also inflationary," he grumbled. "It's as if the money is going from one pocket into another."

Cooperation with Boeing

19. (C) Chemezov said that the Boeing-VSMPO JV "Ural Boeing Manufacturing Plant" (which will produce parts for the Boeing 787/Dreamliner) was scheduled to open in June or July. Local production would not only lower transport and packing costs for Boeing, but produce jobs for Russians and profits for Rostekhnologii, he noted. He commented that commercial successes such as the Boeing-VSMPO partnership could do much to offset the occasional political fluctuations in the bilateral relationship.

110. (C) Chemezov said he would be meeting with Boeing executives Scott Carson and Sergey Kravchenko in early April to discuss the timing of the JV opening (which he suggested could be coordinated with possible POTUS visit). He invited the Ambassador to attend a meeting he was organizing for the Boeing execs with Deputy Prime Minister Shuvalov.

111. (C) Chemezov added that Rostekhnologii's aviation arm,

Rosavia, was interested in purchasing a large volume of foreign aircraft (either Boeing or Airbus) to modernize its fleet and make it fuel efficient. Rosavia was preparing a tender for the purchase of about 100 aircraft which would be presented to both Boeing and Airbus. Chemezov said that Rosavia was about to send a delegation to the U.S to discuss possible purchase of Boeing aircraft. A selling point for Boeing was the fact that spare parts could be produced in Russia. Chemezov added, however, that the Airbus 320 had a more modern design than the Boeing 737. On the other hand, the larger Boeing 767 was more suitable for long-haul passenger flights, and would be ideal for Rosavia's cross country flights to Vladivostok and Khabarovsk. (Chemezov's staff later told us that Rosavia might consider a purchasing a combination of Boeing 737 and 767 jets if Boeing wins the tender).

¶12. (C) In the future, Chemezov said Rosavia would most likely procure locally produced aircraft, but the Russian manufacturer United Aircraft was not yet geared up for production. In the meantime, Rosavia would be exempt from customs duties on imported aircraft. Eventually, he said air passenger traffic would be divided between Rosavia (taking over all of the domestic routes) and Aeroflot (holding on to the international flights). Chemezov said the government was prepared to subsidize air travel between western Russia and the Russian far east.

Avtovaz and GM

¶13. (C) Chemezov said production of the Lada and GM Niva models at GM's joint venture with Avtovaz would be cut by one half this year. To cover losses (owing to the fall in Russian car sales from 2.8 million to 1.8 million in the course of a year), the firm would sell some of its finished product abroad for foreign exchange. He explained that Russian consumers no longer wanted to spend on expensive consumer goods and were "saving for a rainy day". For that reason, he said, Avtovaz was designing an inexpensive "car for the people" which would be sold at a price "accessible to all". Avtovaz was also investing a new conveyer belt to manufacture a "slightly higher class Lada".

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Comment

¶14. (C) Although closely identified with one of the Kremlin's shadowy siloviki clans, Chemezov was candid about Rostekhnologii's financial plight, production problems and potential cuts, particularly in the defense industry. He also seemed genuinely supportive of Rostekhnologii's business ties with GM, Boeing and another Western firms, and acknowledged the need for foreign investment to modernize those elements of the conglomerate that will survive the crisis. End Comment.

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